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SIPDIS

SENSITIVE

TREASURY FOR SONAL SHAW

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TAGS: [EFIN](#) [ECON](#) [NI](#)

SUBJECT: NIGERIA: IMF PROGRAM IS NECESSARY TO KEEP GON IN CHECK

REF: (A) ABUJA 2301 (B) STATE 176085

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**¶1.** (SBU) Summary. Embassy Abuja supports continued IMF engagement with Nigeria despite the GON's failure to complete the current Stand-by Arrangement. We believe extending the current SBA through December followed by a new SBA is the best option. The extended program could emphasize restraints on spending for the remainder of 2001 and a reduced spread between official and IFEM rates. A new 2002 program should focus on budget priorities and structural reform; less spending on unviable public enterprises and more on poverty alleviation. End Summary.

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Background  
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**¶2.** (SBU) From the outset, Nigeria had difficulty adhering to the Stand-By Arrangement negotiated in August 2000. None of several IMF reviews was successfully "completed" because the GON had not met the targets. The last review in September 2001 -- the SBA expires October -- was unsatisfactory (Ref A), and prompted a high-level Nigerian delegation to visit Washington, promising a renewed commitment to work with the Fund (Ref B). The GON argues that it has, in fact, met most targeted benchmarks; asserting the IMF never specified the unmet targets were the most critical. Out of fourteen targets, four were unmet. These four involved federal government spending, liquidity absorption by the Central Bank, and a widening of the spread between the parallel and official exchange markets (and the concomitant excess in foreign exchange sales in the official market).

**¶3.** (SBU) The questions now are to what extent the IMF is willing to compromise its standards to accommodate a more politically-palatable outcome and what effect termination of the IMF program would have on the Nigerian economy and its political system. The answers are complex, but this cable attempts to identify the costs and benefits of retaining an IMF program.

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Poor Macroeconomic Performance, But Some Reforms  
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**¶4.** (SBU) Macroeconomic performance declined over the last year. Inflation accelerated to double-digit levels since August 2000 (18.7% in August 2001), and instability has prevailed in the foreign exchange market with the premium in the parallel market fluctuating between 14-20%. An index of the purchasing power of the Naira (a rough indicator of changes in competitiveness) has fallen to new lows as inflation has risen and the IFEM (official) rate has appreciated since April 2001.

**¶5.** (SBU) High inflation and foreign exchange instability is largely attributable to excess liquidity (almost wholly a cash economy) and large government expenditures. The 2001 budget and supplementary budget called for sharply higher spending (over 2000) and raised concerns about the quality of spending (i.e., "value for money") and budget priorities. Huge spending on Ajeokuta steel works and the National Stadium, for example, cast doubt on whether the GON's priorities truly lie in poverty alleviation. Unfortunately, efforts at monetary tightening came too late and were too gradual to forestall inflationary pressures.

16. (SBU) Nevertheless, the Fund recognizes a series of useful, if modest, achievements made over the last two years that offer a basis to further pursue both market-based reforms as well as restoration of macroeconomic stability. These achievements include progress on privatization, creation of quasi-independent debt management and budget offices, efforts to increase transparency in tariffs and trade policy, and the establishment of the Anti-Corruption Commission.

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Nigeria's Renewed Commitment to the IMF Program  
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17. (SBU) President Obasanjo has personally written to the IMF Managing Director, reiterating his commitment to the policies embodied in the SBA, despite the array of political and constitutional constraints that often complicate implementation. The recent visit to Washington of the Finance Minister and Central Bank Governor, as well as many conversations with staff at the CBN, Finance Ministry and Presidency, demonstrate the underlying political commitment of the President. President Obasanjo has promised to restore fiscal prudence, which, together with sustained monetary efforts and prudent exchange rate management, would help ensure macroeconomic and exchange rate stability.

18. (SBU) On this basis, an IMF mission is visiting Nigeria beginning October 17 to determine what to do in the face of the imminent lapse of the SBA. The only viable options are (a) to extend the timetable to December for achieving agreed targets and negotiate a new program after December; (b) allow the SBA to lapse at the end of October and replace it, perhaps, with a less formal arrangement until a new program could be established; or (c) allow the SBA to lapse and not continue a new program.

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Benefits of an IMF Program  
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19. (SBU) The U.S. Mission shares concern that Nigeria has not made the progress expected under the existing SBA. Nevertheless, it is imperative for the Nigerians to maintain a strong relationship with the IMF. Despite the mixed performance, Nigeria has begun to reap benefits under the SBA, including the following:

a) The SBA has provided Nigeria with a unique opportunity to keep the international community duly informed about its economic policies, challenges and opportunities. Consequently, the SBA has helped restore credibility, rebuild confidence and foster partnership with the international community. For a country emerging out of a pariah status, and which has gone through decades of mismanagement, this is a welcome development.

b) The IMF-supported program has rebuilt confidence and rekindled investor interest. This has, to some degree, resulted in modest investment inflows and facilitated access to import credit. Over the medium term, Nigeria could derive significant financial benefits from this positive shift.

c) The SBA paved the way for rescheduling Nigeria's debts with the Paris Club, which consisted mainly of arrears and penalties on payments due. This rescheduling agreement eased the debt service burden for Nigeria in 2001, while laying a possible basis for future debt relief. Without the rescheduling arrangement, Nigeria would have defaulted further on its obligations to creditors. A renewed IMF program is also critical for Nigeria to continue debt rescheduling negotiations with the Paris Club creditors.

d) Although the Nigerian Government opted not to utilize the \$1 billion loan extended under the SBA, it represented an overdraft facility that could be tapped during periods of adversity, which therefore improved the country's economic profile.

e) The SBA helped create a somewhat improved policy framework, focus and financial discipline required by Nigeria to implement an effective economic reform program. Without this more disciplined and focused framework, the modest gains recorded during the period would have been different, especially given the political pressures.

f) The SBA has provided Nigeria an opportunity to exploit the expertise of the IMF, which has facilitated the design, implementation and monitoring of Nigeria's economic program. The partnership has had the indirect benefit of enhancing the IMF's image in its relationship with Africa.

¶10. (SBU) In view of the benefits stated above, Nigeria's renewed political commitment may pave the way for successful extension of the program. However, political pressures to increase spending will only grow between now and the 2003 elections. Nigerians widely accept as a fact of life that spending will climb prior to the elections. Officials, such as the Chief Economic Advisor to the President, have openly admitted that low spending targets may be unrealistic until after the elections.

¶11. (SBU) In spite of the political realities, the discipline induced by an IMF arrangement will moderate these pressures to some degree, helping the Executive not only restrain spending this year, but fight for a fiscally responsible 2002 budget. Evidence of support for a higher 2002 budget can already be seen in the Call Circulars, sent to Ministries requesting budget submissions, indicating further spending increases over 2001 levels and unrealistic revenue assumptions. If the actual budget reflects this trend, there is a real danger that macroeconomic performance in 2002 could fall below 2001, making the prospects of a new IMF facility remote.

¶12. (SBU) The need for a cautious budget stance is highlighted by uncertainties over the price of petroleum. The GON has not committed itself to saving oil revenues in anticipation of leaner years. Moreover, the Federal Government's share of revenue under the proposed revenue sharing formula could be reduced from about 56% to 47% of the Federation Account. Nigeria needs the Fund's counsel on macroeconomic management: the best way to do this is through a SBA.

¶13. (SBU) More important than spending levels, however, is how the money is spent; good macroeconomics, though essential, is not enough. An IMF program should adhere to prudent budget priorities. For example, less spending on unviable public enterprises in aluminum, fertilizer, and steel and more spending on basic health care, education and agriculture. Structural reforms could be encouraged, such as removing the fertilizer subsidy, deregulating petroleum prices, simplifying tariff structure, merging parallel/IFEM exchange rates and structuring interest rate flexibility necessary for monetary management. Focus on anti-corruption needs to continue.

¶14. (SBU) Without an IMF program, Nigeria would face crippling debt-servicing payments, with potentially serious economic and political domestic implications and disastrous repercussions for Nigeria's financial status abroad. Debt servicing payments would exceed USD 2.5 billion annually that, according to the GON Debt Management Office, would be unrealizable. Without the focused framework of an IMF facility and access to the IMF's macroeconomic expertise, fiscal and monetary policies could become even more undisciplined. Less fiscal restraint and higher debt servicing could result in unsustainable deficits at a time when government revenue is likely to decline due to low world oil prices. Large deficits, combined with import dependency and a mono-product economy, would cause spiraling inflation and foreign exchange market instability. The Nigerian government would be left with the Hobbesian choice of reneging on debt obligations or facing a severely crippled economy; neither of which is really a choice.

¶15. (SBU) Meeting the targets under the existing SBA, if extended, and a new SBA, if negotiated, will require political resolve, particularly on budget formulation and implementation. The Mission has expressed support to the GON for its continued engagement with the IMF. The USG, in concert with the entire international community, needs to continue to impress upon the GON that a strong reform program including both macroeconomic and structural elements is necessary both for poverty reduction and long term debt relief.

Jeter